

FERC Technical Conference Re: Wholesale Market Design
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A. Thank you for bringing the Successful Market Design (SMD) train to CA and thank you for last week's well-reasoned MD02 order

- 1) Best FERC order ever issued on CAISO matters**
- 2) Demonstrates thoughtfulness, competence, and renewed vigor to get the job done**

B. For 30 years, positive and negative influences from California have driven FERC toward more efficient transmission pricing and access policies

- 1) First, in the infamous "quad-sevens" case, California litigants proved that the "wheeling" model, with its vague property rights based on the contract path fiction, could be used to support a 20-year proceeding accomplishing nothing other than confirming the need for new pricing rules**
- 2) Largely to prevent similar occurrences, the FERC opened an inquiry into transmission pricing during the mid-1980s**
 - i. Comm. Stalon argued that the access issue would solve itself if we only knew how to price transmission service efficiently**
 - ii. No answers were forthcoming, so the inquiry ended in failure**
- 3) A few years later, in seeking to introduce retail competition, California stumbled onto a two-part solution to the problems that had always blocked efforts to move beyond the simplistic wheeling model**

- i. **First, an independent system operator to consolidate operationally the balkanized grid under one standard tariff**
 - ii. **Second, a spot market based on LMP and financial transmission rights to price transmission service consistent with the physics of electricity**
 - iii. **Unfortunately, the break-through market design that was born in California was not adopted for use in California, but it did quickly gained acceptance in the eastern markets**
- 4) A few years later, California became a world-wide poster child for profoundly unsatisfactory results caused by a mixture of unworkable market design, resource scarcity, and unsuccessful political and regulatory intervention**
- 5) Now, California has an opportunity to fix its broken market, and once again make a positive contribution toward advancing the Commission's policy goals**
- C. While reform of the CAISO tariff is headed in the right direction, the process is taking too long. MD02 is now more properly called MD05**
- D. The reasons might be in doubt, but the slow pace is undeniable. Here is what the Commission should do to finish the job**
 - 1) Establish reasonable CAISO implementation milestones, and demand implementation filings in accordance with that schedule**
 - 2) Say "yes" only to those elements of MD05 that you believe will support successful market design**
 - 3) Negotiate an independent governance arrangement for the CAISO rather than waiting for the DC Circuit to act**

- 4) Negotiate/establish a division of labor between FERC and the California Regional State Committee, but leave it to California authorities to determine the composition of the committee and how it should do its work.**
- 5) Instruct the California market monitor that focusing on market re-design to correct distorted economic incentives is likely to be more productive in reaching competitive outcomes than suppressing spot prices and layering on penalties to control behavior**
- 6) Preserve sharp, locational spot prices – they are needed to support efficient system operations and signal the need for new investment. Price-dulling, short-run market power mitigation measures are both harmful and unnecessary if effective resource adequacy measures are implemented instead**
- 7) Protect “native” California load through auction or allocation of financial transmission rights – not with preferential “physical” access to the grid**
- 8) Allocate the costs of rate-based transmission upgrades to the California consumers that are expected to benefit – mandatory socialization of these costs undermines competition**
- 9) Insist that every western RTO use successful market design “blue prints” in order to ensure internal workability and external compatibility**
 - i. California has taught you not to defer to experiments that comport neither with theory nor practice**